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SIPDIS

STATE FOR WHA/CAR (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

TREASURY FOR L LAMONICA

E.O. 12958: NA

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SUBJECT: JAMAICAN BUSINESS CONFIDENCE PLUNGES

1. Summary: Data published by the Jamaica Conference Board on October 12 revealed that business confidence for the September quarter plunged to its lowest level since the second quarter of 2003. High levels of pessimism about the country's economic prospects underlined the significant decline in business confidence. This was in contrast to consumer confidence, which improved over the previous quarter, reflecting the relatively buoyant mood of residents in tourist areas. Most consumers rated current economic conditions as average or better than average during the third quarter and expected conditions to remain largely unchanged during upcoming periods. While price instability has begun to impact on business confidence, international investors remain bullish about the country's economic fundamentals and ability to repay debt. This was evidenced by the GOJ'S ability to raise USD 250 million on the external capital market on October 10. However, confidence could be tested during 2006 if the GOJ is unable to arrest the price instability. End summary.

2. According to data released by the Jamaica Conference Board (JCB) on October 12, Jamaican business confidence sunk during the September quarter, posting its largest decline during the four-year period of the survey. The index of business confidence was 97.2 in the September quarter, down from 122.8 in the June quarter. This 21 percent decline in business confidence obliterated all the gains recorded since 2004. The significant decline in confidence was underpinned by pessimism about economic prospects by firms in all industries and of all sizes. Almost 90 percent of all firms thought that the Jamaican economy had declined in the review quarter, while about 70 percent of all firms expected the economy to worsen due to oil prices, economic and crime concerns. The anticipated slowdown in the US economy is also expected to have a dampening impact on tourism. According to Professor Richard Curtin of the University of Michigan, who analyses the data for the JCB, this was the least favorable Jamaican economic outlook recorded since the September 11 terrorist attacks in the United States. During the September quarter, one-in-three firms reported that profits were lower than projected, while fewer firms expected improved profitability in upcoming quarters due to the inability to pass on the higher cost of energy to consumers. Influenced by concerns about oil prices, taxes, economic policies, interest costs and crime, fewer firms were willing to invest in expanding productive capacity.

3. In contrast, the index of consumer confidence rose by nine percent to 108.9, reflecting the relatively buoyant mood of residents in tourist areas. This mood contradicts the constant reports from hoteliers that the sector is in crisis. Almost sixty percent of consumers rated current economic conditions as average or better than average during the third quarter and expected conditions to remain largely unchanged during upcoming periods. Jamaicans were also more upbeat about the current availability of jobs, although apprehensions about job prospects have increased. Like businesses, consumers are anticipating increased prices. The surge in oil prices has begun to feed inflationary expectations, with over 90 percent of all Jamaicans expecting higher inflation during the year ahead. As a consequence, most Jamaicans are anticipating increased income to compensate for the higher inflation.

4. Higher than anticipated inflation has begun to drive uncertainty among Jamaicans. Inflation of 10.1 percent for April to September has already surpassed the GOJ'S full fiscal-year target of nine percent. Rising oil prices (gas prices have doubled since January 2005) have fueled most of the inflationary impulses. Higher domestic food prices due to the impact of two hurricanes and an increase in consumption taxes, bus fares and utilities have also fed inflation. The higher inflation, which has outpaced wage increases, has led to a falloff in consumption and by extension sales. With businesses finding it difficult to pass on the full impact of especially the oil price increase, profits, investment activity and overall economic expansion have remained

sluggish. The slow depreciation in the exchange rate, the expansion in the fiscal deficit relative to target and the sluggish economic performance have also provided additional impetus for the reduction in business confidence.

15. Amidst the drop in confidence, the GOJ was able to raise USD 250 million by way of a Global Eurobond with a 25-year maturity and a 9.25 percent interest coupon on October 10. The instrument was well received by external investors amidst rising US interest rates and at a time when the external capital market has been wary of emerging market debt. This is the third time the GOJ has been able to raise external funds during 2005, suggesting that international investors still maintain a high level of confidence in the country's economic fundamentals and ability to repay debt. However, unless the GOJ is able to arrest inflation, the country could face some macroeconomic challenges in 2006 when most wage contracts come up for negotiation. Workers in general and public sector employees, who have been reluctantly engaged in a wage restraint agreement with the GOJ, will seek substantial increases in wages to compensate for the loss in purchasing power. However, generous wage increases could provide further impetus for inflation and inflationary expectations and could impact the exchange rate, further eroding confidence.

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